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4 **UNITED STATES DEPARTMENT OF JUSTICE**  
5 Office of the United States Trustee  
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6 Attorneys for the Acting United States Trustee  
7 **SARA L. KISTLER**

8  
9 **UNITED STATES BANKRUPTCY COURT**  
10  
11 **DISTRICT OF NEVADA**

12 In re:

13 **USA Commercial Mortgage Company**  
14 **06-10725 -- Lead Case**

**Jointly Administered**

Chapter 11 Cases

Judge **Linda B. Riegle** Presiding

15 **USA Capital Realty Advisors, LLC**  
16 06-10726

Date: **July 25, 2006**

Time: **9:30 a.m.**

Affecting:

All Cases

or Only:

USA Commercial Mortgage Company  
 USA Capital Realty Advisors, LLC  
 USA Capital Diversified Trust Deed Fund,  
LLC

USA Capital First Trust Deed Fund, LLC

17 **USA Capital Diversified Trust Deed Fund, LLC**  
06-10727

18 **USA Capital First Trust Deed Fund, LLC**  
06-10728

19 **USA Securities, LLC**  
06-10729

Debtors

20 **THE UNITED STATES TRUSTEE'S SUPPLEMENTAL OPPOSITION TO**  
21 **APPLICATIONS BY DEBTOR AND DEBTOR-IN-POSSESSION FOR**  
22 **AUTHORIZATION TO RETAIN AND EMPLOY SCHWARTZER &**  
23 **MCPPERSON LAW FIRM AS COUNSEL UNDER GENERAL RETAINER**

24 To the Honorable **LINDA B. RIEGLE**, United States Bankruptcy Judge:

25 The United States Trustee has previously opposed, and continues to oppose, the  
26 Applications by Debtor and Debtor-in-Possession for Authorization to Retain and Employ  
27 Schwartzer & McPherson Law Firm as Counsel Under General Retainer in each of the five  
separate Chapter 11 cases identified in the caption. *See* Docket #222. Supplementation of the

1 United States Trustee's opposition as originally filed is necessary to address subsequent events  
2 which substantiate the United States Trustee's opposition. This supplement is supported by the  
3 United States Trustee's opposition as originally filed and incorporated herein by this reference,  
4 the pleadings and papers comprising the official court file in this case, and the following  
5 Memorandum of Points and Authorities.

6 **MEMORANDUM OF POINTS AND AUTHORITIES**

7 1. The applications indicate that the Schwartzer & McPherson firm "upon information  
8 and belief, is not aware of any conflicts among the Debtor entities."  
9 2. Through the applications, the Schwartzer & McPherson seeks approval to serve as  
10 counsel for the debtor entity in each of the five different cases pending before the Court.

11 **CONTROLLING STATUTES AND POLICY CONSIDERATIONS**

12 3. The applications, requesting authorization for the Schwartzer & McPherson firm to  
13 serve as counsel for the debtor entity in each of the five different cases at issue, are premised  
14 upon 11 U.S.C. § 327(a).

15 4. The text of 11 U.S.C. § 327(a) provides generally that the trustee may employ one or  
16 more attorneys that do not hold or represent an interest adverse to the estate, and are  
17 disinterested persons, to represent or assist the trustee in carrying out the trustee's duties in  
18 connection with a bankruptcy case.

19 5. The disclosures required of a professional seeking employment under 11 U.S.C.  
20 § 327(a) are set forth in Fed. R. Bankr. P. 2014(a).

21 6. In addition to the provisions of 11 U.S.C. § 327(a), the issues here turn on the  
22 provisions of 11 U.S.C. § 327(c). Section 327(c) generally provides that while an attorney is  
23 not disqualified from employment on behalf of the trustee solely because he or she represents a  
24 creditor, upon objection by the United States Trustee "the court shall disapprove such  
25 employment if there is an actual conflict of interest."

26 7. The policy objectives of 11 U.S.C. § 327 include holding professionals performing  
27 duties for the estate to strict fiduciary standards, and to assure that a professional employed in a  
28 bankruptcy case will devote undivided loyalty to the client. In re Wheatfield Bus. Park, LLC,

1 286 B.R. 412, 417-18 (Bankr. C.D. Cal. 2002), *citing In re Envirodyne Indus., Inc.*, 150 B.R.  
 2 1008, 1016 (Bankr. N.D. Ill. 1993) *and In re Lee*, 94 B.R. 172, 178 (Bankr. C.D. Cal. 1988).  
 3 "Having to divide one's allegiance between two clients is what Section 327 attempts to prevent."  
 4 *In re Mercury*, 280 B.R. 35, 54 (Bankr. S.D.N.Y. 2002), *quoting In re Roger J. Au & Son, Inc.*,  
 5 101 B.R. 502, 505 (Bankr. N.D. Ohio 1989).

6 **AUTHORITY AND ARGUMENT**

7 **SINCE PROPOSED COUNSEL HAS NOW ACKNOWLEDGED THAT AN**  
**ACTUAL CONFLICT OF INTEREST EXISTS BETWEEN THE DEBTORS, THE**  
**APPLICATIONS SHOULD BE DENIED.**

8 8. Subsequent to the May 12, 2006 filing of the United States Trustee's original  
 9 opposition to the applications, on July 18, 2006, Debtor USA Commercial Mortgage Company  
 10 filed an "Application by Debtor and Debtor-in-Possession for Authorization to Retain and  
 11 Employ David W. Huston *as Special Conflicts Counsel* Under General Retainer." *See* Docket  
 12 # 883 (emphasis added).

13 9. That motion expressly acknowledges that because one set of attorneys has been  
 14 representing all five of the debtors in these five separate Chapter 11 cases, it has now become  
 15 necessary to hire another attorney in these proceedings to address "matters where USACM's  
 16 bankruptcy counsel, Ray Quinney & Nebeker and Schwartzer & McPherson Law Firm have a  
 17 conflict of interest or an appearance of a conflict of interest" in connection with an interpleader  
 18 action "in which USACM will be the plaintiff and USA Capital First Trust Deed Fund (the  
 19 "FTDFund") will be a defendant." The interpleader action is needed "to determine the  
 20 ownership of the funds in USACM's Ivestor Trust Account which contains approximately which  
 21 contains approximately \$1.7 million and against which there are approximately \$3.4 million in  
 22 claims by persons who either sold or purchased fractional interests in direct loan investments",  
 23 including a \$100,000.00 claim held by debtor USA Capital First Trust Deed Fund. *See* Special  
 24 Counsel Motion, Docket # 883, at para. 2.

25 10. The special counsel application also expressly acknowledges that "Bankruptcy  
 26 counsel for USACM believes that it would appear to be inappropriate for counsel, who also  
 27 represents FTDFund in these proceedings, to represent either USACM or FTDFund in this  
 28

1 litigation." *Id.* The United States Trustee agrees, and contends that the same logic applies with  
 2 respect to representation of all of the debtors by a single set of attorneys.

3       11. In addition, debtor USACM has sought to obtain debtor in possession financing on  
 4 two separate occasions under terms that offered a lien to the proposed lender not only on the  
 5 assets of debtor USACM, but also a "priming lien" on the unencumbered assets held by two  
 6 other debtors, USA Capital First Trust Deed Fund and USA Capital Diversified Trust Deed  
 7 Fund. *See* Docket # 171, 254 and 588.

8       12. An "actual" conflict of interest in the context of 11 U.S.C. § 327 is "an active  
 9 competition between two interests, in which one interest can only be served at the expense of the  
 10 other." In re Mercury, 280 B.R. 35, 54 (Bankr. S.D.N.Y. 2002)(citations omitted).

11       13. "Section 327(a) prohibits an attorney (or other professional) from representing a  
 12 debtor in a chapter 11 case if the attorney has or represents an actual conflicting interest. This  
 13 prohibition is absolute, and is not subject to waiver or consent." In re Wheatfield Bus. Park,  
 14 LLC, 286 B.R. 412, 420-21 (Bankr. C.D. Cal. 2002)(citations omitted); *see also* In re Interwest  
 15 Bus. Equip., Inc., 23 F. 3d 311, 315-16 (10th Cir. 1994)(Where a "creditor or the U.S. Trustee  
 16 objects, the bankruptcy judge can disqualify a professional *solely* on the basis of simultaneous  
 17 representation, *if* it finds the joint representation creates an actual conflict.")(emphasis in  
 18 original); *see generally* 11 U.S.C. § 327(c)(where objection to retention of a professional is made  
 19 by the United States Trustee, "the court shall disapprove such employment if there is an actual  
 20 conflict of interest.").

21       14. The filing of multiple motions seeking to obtain the benefit of debtor in possession  
 22 financing for one debtor (USACM), at the expense of two other debtors (the Funds) and the  
 23 unencumbered assets held in their estates, confirms the presence of an existing and "actual"  
 24 conflict of interest in the context of 11 U.S.C. § 327. Such conduct clearly demonstrates the  
 25 presence of "an active competition between two interests, in which one interest can only be  
 26 served at the expense of the other." In re Mercury, 280 B.R. at 54.

15. The standard under 11 U.S.C. § 327 is very high: "If there is any doubt as to the existence of a conflict, that doubt should be resolved in favor of disqualification." Wheatfield, 286 B.R. at 418, *citing Lee*, 94 B.R. at 177.

16. Because an actual conflict exists between the interests of USA Commercial Mortgage Company on one hand, and USA Capital Diversified Trust Deed Fund and USA Capital First Trust Deed Fund on the other, the retention proposed in the applications violates the provisions of 11 U.S.C. § 327, and must therefore be denied. *See Wheatfield*, 286 B.R. at 421 ("[A]n actual conflict of interest creates a violation of § 327.").

## **CONCLUSION**

The United States Trustee therefore respectfully requests that the Court enter an order denying the applications, and granting such other and additional relief as is just and equitable.

Respectfully submitted,

**SARA L. KISTLER  
ACTING UNITED STATES TRUSTEE  
REGION 17**

By: /s/ August B. Landis

August B. Landis, Assistant United States Trustee  
United States Department of Justice